

eport to Congression Requesters

April 1993

FINANCIAL MANAGEMENT

Agencies' Actions to Eliminate "M" Accounts and Merged Surplus Authority



OSD CASE # 9279



U 2d States General Accounting Office Washington, D.C. 20548

Accounting and Financial Management Division

B-245856

April 2, 1993

The Honorable John Glenn Chairman, Committee on Governmental Affairs United States Senate

The Honorable Earl Hutto Chairman, Subcommittee on Readiness Committee on Armed Services House of Representatives

This report responds to your requests and that of former Representative Andy Ireland regarding implementation of Public Law 101-510, which changed the way federal agencies are to account for and report on expired and closed appropriation accounts, including "M" accounts and merged surplus authority.

Background

The Congress provides authority for obligating the federal government and withdrawing money from the Treasury through separate appropriation accounts for various purposes. Obligation authority associated with these accounts generally lapses after 1 year, but some appropriations, particularly for the Department of Defense (DOD), carry authority for multiple years before the appropriation expires. Accounting procedures for the activity under each appropriation account were designed to ensure strict compliance within each account, both before and after the appropriation expires. Under the old law, after an appropriation account had been expired for 2 years, its remaining obligated, but as yet unpaid, balances were combined with like appropriation accounts from prior years into merged accounts, commonly called "M" accounts. Also, the unobligated balances of these expired appropriations were likewise combined into merged surplus authority accounts.

The government operated under this structure for about 35 years. But the Congress found that the intended controls were not working and that DOD. which had most of the "M" and merged surplus authority accounts, was expending funds from these accounts without sufficient assurance that authority for such expenditures existed or in ways that the Congress did not intend. The Congress was particularly concerned about (1) the large balances available to DOD in the "M" and merged surplus accounts. which totaled a reported \$50 billion at the time of the new law, (2) DOD's access

to and routine use of hundreds of millions of dollars from the "M" accounts and merged surplus authority to cover contract cost increases. and (3) the lack of congressional oversight of these accounts.

Therefore, under the new law, which was enacted November 5, 1990, merged surplus authority was canceled effective December 5, 1990, and the "M" accounts will be phased out by September 30, 1993. To improve congressional oversight and control over spending of appropriation accounts, the new legislation includes the following provisions:

- Agencies are required to maintain records for each expired appropriation account reflecting obligated and unobligated balances by year for 5 years.
- Obligated and unobligated balances are canceled 5 years after the budget authority expires regardless of whether or not goods or services contracted for have been provided. Thereafter, obligations and upward adjustments that would have been chargeable to the canceled appropriation account may only be paid out of current appropriations.

In order to ensure that obligations and expenditures do not exceed the amounts appropriated, agencies will have to maintain adequate records by fiscal year of obligated, unobligated, and expended balances of current, expired, and canceled budget authority. Appendix I contains a more detailed explanation of the technical provisions of Public Law 101-510.

In response to your and former Representative Andy Ireland's requests, we are providing detailed responses to 13 questions, which are presented in appendix II of this report.

Results in Brief

Overall, we found that the Office of Management and Budget (OMB) and the Department of the Treasury had issued complete and timely guidance to implement Public Law 101-510. However, the guidance did not address the accounting for financial liabilities that may be incurred on contracts that remain after their budget authority has been canceled. OMB said it would issue additional guidance for the financial reporting of canceled obligations by May 1993.

The six civil agencies we reviewed had adequately implemented the OMB and Treasury guidance. However, our review at DOD identified serious problems in implementing the new law. In order to gain control over the status of DOD's "M" accounts, Public Law 101-510 required DOD to audit all its outstanding "M" account obligations by December 31, 1991, to

(1) establish the amounts required for valid obligations and (2) identify and cancel amounts found to be invalid. However, DOD made hundreds of millions of dollars of adjustments without completing the required audit of its \$18.8 billion of "M" account balances. DOD advised us that it plans to complete this audit sometime before September 30, 1993.

Over the years, DOD had not maintained adequate financial controls over its "M" account balances. For example, Air Force restored \$649 million in unsupported obligations from merged surplus authority to its "M" accounts so that the obligation balances in departmental and field level records would agree. The Air Force did not determine which records were accurate and could not link the restorations to specific obligations.

Also, although DOD had not completed an audit to determine its total obligations, it reobligated over \$259 million of deobligated "M" account balances as of July 31, 1992. We view DOD's practice of deobligating and reobligating "M" account balances prior to completing the audit as inconsistent with the purpose and objective of section 1406 of Public Law 101-510 and brought this matter to the attention of congressional offices. Because of concern over DOD's actions to reobligate these balances, effective October 1, 1992, the Congress put stricter limits on these reobligations.

\$46 million in violation of the Antideficiency Act and charged the overobligations to current year appropriations. The Antideficiency Act prohibits agencies from making expenditures or incurring obligations in excess of, or in advance of, available appropriations. The Congress subsequently enacted Public Law 102-484, section 1004, which authorizes DOD, subject to certain limitations, to charge current year funds for obligations and adjustments to obligations normally chargeable to expired year accounts. Any overobligation of the expired accounts resulting from the use of current year funds remains a reportable violation of the Antideficiency Act.

DOD disagreed or partially disagreed with certain of our assessments regarding compliance with Public Law 101-510; however, it did not provide support for its positions.

Objectives, Scope, and Methodology

Our objectives were to (1) assess the guidelines for implementing Public Law 101-510, (2) evaluate agency compliance with the applicable

45856

guidelines, and (3) address other specific issues you raised. To do this, we reviewed implementation actions by OMB, Treasury, and the seven agencies with the largest "M" account balances. In total, these seven agencies had \$26.2 billion or 95 percent of the \$27.4 billion of federal executive agency "M" account balances as of September 30, 1990. The seven agencies selected for detailed review were the Departments of Defense, Education. Health and Human Services, Housing and Urban Development, Labor, and Transportation and the Agency for International Development. We performed our work between August 1991 and October 1992 in accordance with generally accepted government auditing standards.

Responsible officials of the Office of Management and Budget and the six civil agencies we visited provided comments on the findings, conclusions, and recommendations in this report. Their comments are incorporated where appropriate. The Department of Defense provided written comments on a draft of this report. These comments have been presented and evaluated where appropriate, and DOD's comments on our findings and recommendations are included in appendix IV.

Appendix III contains more detailed information on our objectives, scope, and methodology.

Some DOD Actions Were Unsupported, Incomplete, or Inappropriate

Public Law 101-510 permitted federal agencies to restore merged surplus authority for proper "M" account obligation adjustments incurred prior to December 6, 1990. DOD accounted for 47 percent or \$1.7 billion of the total \$3.6 billion of federal agency merged surplus authority restorations. A DOD Inspector General (IG) review of DOD's restorations concluded that \$849 million or about 50 percent were not adequately supported and accordingly should not have been restored. While the DOD Comptroller disagreed with the 1G's conclusion, our review of a \$649 million Air Force restoration, which represents over 75 percent of the balance questioned by the 1G, confirmed the 1G's finding that the restoration was not adequately documented and thus should not have been made. DOD officials told us that the \$649 million restoration represented an unsupported correction of 30 years of cumulative accounting errors between Air Force departmental control accounts and field level records. However, DOD officials could not link the restorations to specific documented obligations. DOD knew that these two levels of records did not agree in total but does not know which, if either, is correct. DOD arbitrarily accepted the base level records as correct and used them as the justification to restore \$649 million in

B---6866

obligational authority from the merged surplus account that otherwise would not have been available to it.

Section 1406 of Public Law 101-510 required DOD to conduct a one-time audit of each "M" account balance to establish balances in the "M" accounts that were supported by valid obligations. Obligation balances identified during the audit that were not adequately supported were to be deobligated and canceled. Once canceled, these balances were not available for any purpose. The purpose of the audit was to prevent DOD from using invalid amounts in "M" accounts that DOD had accumulated over the years to fund upward adjustments to other valid obligations. The audit was to have been completed by December 31, 1991.

The Secretary of Defense assigned the audit responsibility to the DOD Inspector General. As of December 31, 1991, the 1G had reviewed a sample of \$5.2 billion or 27 percent of DOD's \$18.8 billion in recorded "M" account balances. Of the \$5.2 billion of balances reviewed, the 1G determined that \$2.9 billion were supported by valid obligations and \$2.3 billion were not. The 1G concluded that DOD's "M" account balances were materially misstated, inadequately managed, and vulnerable to abuse. As of September 30, 1992, DOD activities were attempting to complete the audit started by the 1G. According to the DOD Deputy Comptroller, DOD expects to complete the review before the balances are canceled on September 30, 1993.

Although DOD had not completed the review of its "M" accounts, we found that DOD was routinely deobligating and reobligating "M" account balances. We identified over \$259 million of "M" account balances that were deobligated and reobligated as of July 31, 1992. We view this practice as being inconsistent with the purpose and objective of section 1406 of Public Law 101-510, and we brought this matter to the attention of congressional offices. Subsequently, legislation was enacted on October 23, 1992. as part of the National Defense Authorization Act for Fiscal Year 1993 (Public Law 102-484, section 1003) to limit DOD's reobligation of "M" account balances. Among other things, the law requires that DOD (1) may not reobligate any sum in an "M" account until DOD has identified and canceled an equal sum and (2) provide the congressional defense committees a monthly report. for each month beginning after the date of the enactment of the legislation through September 30, 1993, on the amount of "M" account funds reobligated and canceled during the month. These requirements shall cease to apply prior to September 30, 1993, if DOD completes its audit of

the "M" account balances as required by section 1406 of Public Law 101-510.

Also, on June 13, 1991, DOD directed activities to use current year appropriations instead of the applicable expired years' appropriations to fund contract changes that did not expand the scope of work of the contract. Numerous Comptroller General decisions have held that, unless otherwise authorized by law, such within scope contract changes are chargeable to the appropriation that was initially obligated by the contract even if the appropriation has expired. Following our inquiry, DOD rescinded its policy on April 20, 1992.

Senior Air Force and Navy comptroller officials told us that during the 10 months that the policy was in effect, they obligated \$46 million and \$16 million, respectively, of current year funds for changes that normally would have been charged to expired years' appropriations. The Air Force official advised us that if the \$46 million of changes made by Air Force had been obligated against the expired funds, it could have overobligated the expired account in violation of the Antideficiency Act. The Navy official told us that it had sufficient expired funds to cover its \$16 million of charges. However, Air Force and Navy had not investigated the charges to determine if the expired accounts had been overobligated.

The Congress subsequently enacted Public Law 102-484, section 1004, on October 23, 1992, to address the above situation. This change authorizes DOD, subject to certain limitations, to charge current year funds for obligations and adjustments to obligations normally chargeable to expired year accounts. Thus, DOD is authorized to use current year funds for such things as within scope contract changes normally chargeable to expired years' funds. However, any such use of current year funds would result in an Antideficiency Act violation if the sum of the current and expired years' obligations exceed the total appropriated amount of the expired account.

Guidance Did Not Address Financial Disclosure of Canceled Balances

Although OMB and Treasury guidance generally was responsive to the requirements of the law, it did not require agencies to disclose, in their financial reports, the total amounts of obligations related to canceled budget authority. This is an important consideration because the underlying contracts supporting the obligations recorded against that authority may still require payments.

Public Law 101-510 requires that obligated "M" account balances be gradually canceled by all federal agencies over a 3-year period ending on September 30, 1993. As of September 30, 1991, federal agencies reported canceling about \$4 billion. Because the cancellation of obligated balances does not rescind existing contractual agreements, agency officials told us that many of these canceled balances covered valid obligations that will eventually have to be paid upon the completion of work by the contractors. In April 1992, we briefed omb on the need for additional guidance to require disclosure of canceled balances in agency financial reports. Omb agreed and said it would issue related guidance by May 1993.

Conclusions

DOD's actions gave it access to more budget authority than the Congress contemplated when it enacted Public Law 101-510. Also, DOD obligated current year funds to cover additional contract costs that may have resulted in reportable violations of the Antideficiency Act if the costs had been correctly charged to expired appropriations as is generally required by law. In addition, not disclosing billions of dollars of canceled obligations, even though the related contracts are still active, serves to mask the government's potential liability.

Recommendations

We recommend that the Secretary of Defense direct the DOD Comptroller to implement policies and procedures that require

- the military services and other Defense agencies to deobligate the unsupported restorations of merged surplus authority and
- Air Force and Navy to investigate the charges related to the within scope contract changes that were made to current year appropriations to

 (1) determine whether they would have violated the Antideficiency Act if they had properly charged the expired accounts, and (2) immediately report to the Congress and the President any Antideficiency Act violations confirmed by the investigations.

We also recommend that the Director of the Office of Management and Budget require federal agencies to disclose, in their financial reports, obligated amounts that have been canceled as a result of Public Law 101-510 until such time that it is determined that no claims requiring payment remain outstanding.

Agency Comments

OMB and responsible officials at the six civil agencies visited concurred with our findings, conclusions, and recommendations that pertained to their agencies. OMB stated that it plans to issue additional guidance by May 1993 for agencies to follow when reporting canceled amounts.

Although DOD stated that it generally concurred with our findings and recommendations, its comments, in substance, disagreed or partially disagreed with certain of our assessments regarding compliance with Public Law 101-510. Specifically, DOD did not concur with our finding regarding DOD's lack of documentary evidence to support over \$849 million of merged surplus authority restorations. Although DOD agreed that unsupported restorations of merged surplus authority should be deobligated, it did not agree that there was a lack of documentary evidence to support \$849 million of the \$1.7 billion it restored. However, DOD did not provide support to substantiate its position. Therefore, we do not consider DOD's comment or action taken to be responsive to our recommendation.

In addition, although DOD disagreed with our position that it was improper to use current year appropriations to fund additional contract costs normally chargeable to expired years' accounts, DOD concurred with our recommendation on this issue. Finally, DOD did not agree that it was inappropriate to use deobligated balances to fund obligation adjustments-before the required audit was completed. DOD's comments are discussed as appropriate in appendix II, and its specific comments on our findings and recommendations are included in appendix IV.

We are sending copies of this report to the Secretaries of Defense, Education, Health and Human Services, Housing and Urban Development. Labor, and Transportation; the Acting Secretaries of the Army, the Air Force, and the Navy; the Administrator of the Agency for International Development; the Director of the Office of Management and Budget; and other interested parties. We will also make copies available to others upon request.

Contents

Letter		
Appendix I Background on Provisions of Public Law 101-510		1:
Appendix II 13 Questions and Responses Concerning Agency Implementation of Public Law 101-510		16
Appendix III Objectives, Scope, and Methodology		41
Appendix IV Comments From the Department of Defense		43
Appendix V Major Contributors to This Report		55
Tables	Table II.1: Merged Surplus Authority Restorations and Cancellations for Seven Agencies as of December 5, 1990 Table II.2: DOD Restorations by Activity Table II.3: DOD Estimated Invalid "M" Account Balances as of November 30, 1990 Table II.4: Executive Agencies' No-Year Appropriation Balances as of September 30, 1990 and 1991	18 20 26 39

Contents

Abbreviations

AID	Agency for International Development
DCAA	Defense Contract Audit Agency
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
GAO	General Accounting Office
HHS	Department of Health and Human Services
HUD	Department of Housing & Urban Development
IG	inspector general
ОМВ	Office of Management and Budget

This report was prepared under the direction of Jeffrey C. Steinhoff, Director, Civil Audits, who may be reached on (202) 512-9454 if you or your staffs have any questions concerning this report. Other major contributors to this report are listed in appendix V.

Donald H. Chapin

Assistant Comptroller General

Background on Provisions of Public Law 101-510

Federal agencies receive budget authority through appropriations with differing periods of availability for obligation, normally 1, 2, or 3 years. An obligation represents, for example, an order placed or contract awarded. At the end of the period of availability, the budget authority expires, meaning that any unobligated balance may not be used to incur new obligations.

Prior to the passage of the National Defense Authorization Act for Fiscal Year 1991 (Public Law 101-510, dated November 5, 1990), appropriation accounts maintained their fiscal year identity for 2 years after the period of availability for incurring new obligations had expired. After the 2-year period, the obligated and unobligated balances were transferred and merged into "M" accounts and merged surplus authority, respectively, at which point they lost their fiscal year identity. The merger was with the obligated and unobligated balances of previously closed appropriation accounts available for the same general purpose. These accounts (repositories for balances of prior years' expired budget authority) were used to pay and adjust valid obligations incurred prior to expiration but not for new obligations. Because expired funds were merged after 2 years and lost their fiscal year identity, upward adjustments were not restricted to the amounts available in the appropriation originally obligated.

Since the Congress established the "M" accounts and merged surplus authority in 1956, the federal agencies' "M" accounts had grown to \$27 billion as of September 30, 1990. Merged surplus authority for the seven agencies in our review had grown to almost \$44 billion as of December 5, 1990. In addition, the use of the merged surplus authority to fund upward adjustments to "M" accounts increased dramatically. For example, we previously reported 1 that Dod's use of merged surplus authority and other expired surplus accounts increased each year over a 5-year period from about \$57 million in fiscal year 1985 to \$560 million in fiscal year 1989.

Don's use of large amounts from the merged surplus authority and expired surplus accounts to cover upward adjustments to obligations prompted the Congress to pass Public Law 101-510 to strengthen its oversight and control over expired appropriations. The new law (1) eliminated the use of merged surplus authority to fund adjustments to "M" account obligations incurred after December 5, 1990, (2) canceled over a 3-year period budget authority associated with obligations recorded in existing "M" accounts,

Expired Appropriations: New Limitations on Availability Make Improved Management by DOD Essential (GAO/NSIAD-91-226, July 18, 1991).

Appendix I Background on Provisions of Public Law 101-510

and (3) made expired appropriations available to agencies for 5 years, after which any unobligated or obligated balances are canceled. Once canceled, the funds may not be used for any purpose including payments for goods and services under contracts that were not yet complete. Also, in making both routine payments and funding upward adjustments of contract costs, agencies will generally be limited to the original amount of budget authority appropriated during a specific fiscal year.

Section 1406 of the law also required DOD to conduct a one-time audit in order to establish the "M" account balances necessary to pay valid obligations as supported by documentary evidence such as active contracts. Obligation balances found not to be supported by documentary evidence were to be deobligated and canceled.

As each year's appropriation reaches the end of the new 5-year expiration period, all obligated and unobligated balances for the appropriation will be canceled. The expired accounts will be closed, and no further obligation adjustments or disbursements may be made from those accounts. Thereafter, obligation adjustments and disbursements that previously would have been chargeable to the expired appropriation account may only be charged to current appropriations. However, agencies may not (1) use more than 1 percent of the current amount appropriated for the same purpose, or (2) make any payment otherwise chargeable to the canceled account that would cause cumulative outlays to exceed the unexpended canceled balance of the original appropriation account. That is, the sum of all obligations and payments related to goods and services originally ordered or contracted for under the canceled account may not exceed the amount appropriated for that account. When the payment of prior years' obligations from current funds would exceed either of these limitations, agencies must seek additional appropriations and defer payment until the appropriation is available. Successfully implementing this provision requires agencies to maintain records by fiscal year of amounts obligated, spent, expired, and canceled.

If obligations or expenditures exceed the amount of available budget authority, a violation of the Antideficiency Act would occur. This act provides that, unless otherwise authorized by law, no officer or employee of the United States shall (1) make expenditures or incur obligations under any appropriation or fund in excess of the amount of available appropriations, or (2) involve the government in a contract or obligation in advance of an appropriation (31 U.S.C. 1341).

Appendix I
Background on Provisions of Public Law
101-510

Public Law 101-510 also provided that any balances in the "M" accounts for more than 5 years as of March 6, 1991 (accounts that expired at the end of fiscal year 1983 and earlier), had to be canceled, with limited exceptions, by March 6, 1991. As mentioned earlier, the act provided a 3-year transition period for cancellation and withdrawal of "M" account balances that remained after March 6, 1991, as follows:

Appropriations that expired in fiscal year	Cancel and withdraw by
1984 /	
1985 /	September 30, 1991
1986-88	September 30, 1992
1000-00	September 30, 1993

At the time of our review, the most current summary-level data available were as of September 30, 1991. As of that date, \$8 billion in expenditures and \$4 billion in cancellations including 1984 and prior years' accounts had reduced "M" account balances for federal executive agencies to about \$15 billion.

On October 23, 1992, the Congress enacted, as part of the National Defense Authorization Act for Fiscal Year 1993 (Public Law 102-484), additional legislation specifically directed at (1) limiting DOD's reobligation of "M" accounts and (2) authorizing an exception to prior restrictions on DOD's use of current appropriations to fund obligations for additional costs normally chargeable to expired accounts. In the area of reobligating "M" accounts, the new law includes the following provisions:

- DOD may not reobligate any sum in an "M" account until it has identified
 and canceled an equal sum under section 1406 of Public Law 101-510. This
 means that for each \$1 of "M" account balances that DOD deobligates and
 reobligates, it must also deobligate and cancel \$1.
- DOD is required to report monthly to the congressional defense committees
 on the amount of "M" account funds reobligated and the amount of funds
 canceled.
- DOD is required to notify the Congress 30 days in advance of reobligating amounts in the "M" accounts that exceed \$10 million for a single purpose.

In the area of funding additional costs, the new legislation provides for an exception to existing requirements that restricts an agency's use of current year appropriations to cover obligations in the expired accounts. The exception authorizes DOD to obligate current year funds available for the same purpose as the expired account for such things as within scope contract changes that normally would have been chargeable to expired



Appendix I Background on Provisions of Public Law 101-510

years' accounts even if that would result in exceeding the amounts available in the expired years' accounts. The new authority is limited, however, to the funding of additional obligations and adjustments to obligations in appropriation accounts that expired in fiscal year 1991 or earlier but have not been closed. Other provisions of the law

- limit the total amount chargeable to current year appropriation accounts
 to the lesser of (1) 1 percent of the total amount of the current year
 appropriations for that account or (2) 1 percent of the total amount of the
 appropriations for the expired account,
- require 30 days advance notice to the Congress before current year funds can be obligated to cover costs associated with expired accounts, and
- restrict DOD from using current year funds until it has certified to the Congress that (1) the limitations for spending and obligating appropriated amounts established pursuant to the Antideficiency Act are being observed and (2) any violations of the Antideficiency Act are being reported to the President and the Congress.

Appendix II

13 Questions and Responses Concerning Agency Implementation of Public Law 101-510

Question 1

Public Law 101-510 required agencies to immediately implement major policy and procedural changes to account for expired appropriations. Were the agencies able to promptly issue policies and procedures to comply with the act?

Response

Yes. Both OMB and Treasury issued guidance to agencies on implementing Public Law 101-510 within about 3 months of its enactment on November 5, 1990. ONB issued Bulletin No. 91-07 Budget Execution Procedures for Closing Accounts (January 17, 1991) to amend OMB Circular A-34, and Treasury issued Bulletin No. 91-03, Merged Surpluses, Closed Accounts, M Accounts and Fiscal Year-end Reporting (February 7, 1991). We found that this guidance was responsive to the requirements of the law. However, the guidance did not address agencies' financial disclosure of liabilities on contracts that remain active after their budget authority has been canceled. This is discussed in more detail in response to question 9.

DOD, in addition to using the OMB and Treasury bulletins, issued interim guidance on December 10, 1990, and revised guidance on June 13, 1991. The military services and responsible Defense Finance and Accounting Service (DFAS) centers issued numerous bulletins and memorandums providing further detailed instructions on how to implement DOD's guidance. Generally, DOD's guidance complied with OMB, Treasury, and legislative requirements. However, we found that DOD's guidance required that, with certain exceptions, all contract changes that result in additional billable work by the contractor be funded out of current appropriations. DOD's guidance regarding contract changes is discussed in more detail in our response to question 8.

The six civil agencies we examined adequately communicated the OMB and Treasury guidance using various methods. For example, the Agency for International Development (AID) sent cables to its overseas missions advising them of the actions required to comply with the law's provisions. Some agencies issued memorandums to their accounting offices instructing them of the impact of the law and limitations on the use of funds, while others updated procedures and issued additional guidelines.

Question 2

The act allowed agencies to restore merged surplus authority to fund previously unrecorded "M" account obligations, and adjustments to those obligations, that were incurred before December 6, 1990, after which the remaining merged surplus authority balances were to be canceled. How much merged surplus authority did agencies restore? How much did they cancel?

Response

Public Law 101-510 prevented the use of merged surplus authority to fund previously unrecorded "M" account obligations or upward adjustments to existing "M" account obligations incurred after the close of business on December 5, 1990. Prior to the act, restorations of merged surplus authority generally would have occurred at fiscal year-end. Thus, any restorations for obligations incurred before December 6, 1990, would normally have been restored at fiscal year-end. To compensate for the December 5, 1990, cancellation deadline, Treasury permitted agencies to immediately exercise the merged surplus authority restoration process to fund unrecorded "M" account obligations, and to adjust "M" account obligations incurred prior to December 6, 1990. Amounts restored were to be reported to Treasury by April 15, 1991, after which, Treasury was to process a restoration warrant ¹ effective December 5, 1990, for the amounts of merged surplus authority to be restored.

Treasury officials informed us that \$3.6 billion of merged surplus authority was restored for all agencies' accounts to fund previously unrecorded "M" account obligations or adjustments to these obligation balances incurred before December 6, 1990. However, Treasury officials were unable to identify the total amount of merged surplus authority balances canceled as they had not maintained records of amounts in these accounts for many years. The seven agencies reviewed reported merged surplus authority restorations of \$3.4 billion and cancellations of \$40.5 billion as shown in table II.1.

Warrants are official documents issued pursuant to law by the Secretary of the Treasury that establish the amount of money authorized to be withdrawn from Treasury.

Table II.1: Merged Surplus Authority Restorations and Cancellations for Seven Agencies as of December 5, 1990

Dollars in millions			
Agency	Merged surplus authority restorations	Merged surplus authority cancellations	Total merged surplus authority as of December 5, 1990
DOD	\$1,696	\$29,304	\$31,000
Labor	•	4,951	4,951
HHS	49	4,294	4,343
AID	1	654	655
Transportation		521	521
HUD	0	475	475
Education	1,637	314	1,951
Total	\$3,383	\$40,513	\$43,896

^{*}Less than \$1 million.

Balance is as of September 30, 1990.

Question 3

Were the amounts of merged surplus authority restored adequately supported?

Response

The six civil agencies we reviewed supported their merged surplus authority restorations, which totaled \$1.7 billion. For example, at the Department of Education, which had \$1.6 billion of merged surplus authority restorations, we analyzed the methodology and supporting documentation for determining the amount of merged surplus authority to restore and found that it was reasonable. We also examined restorations for one appropriation account totaling \$93 million and concluded that the funds had been restored in accordance with Education's policies and methodology.

At DOD, however, both our work and that of the DOD Inspector General (IG) showed that support for the restoration of merged surplus authority was not adequate. Initially, DOD components requested that the DOD Comptroller approve the restoration of \$2.9 billion of merged surplus authority to the "M" accounts to fund previously unrecorded obligations or upward adjustments to obligation balances that were incurred prior to December 6, 1990. However, after DOD Inspector General officials met with DOD Comptroller officials to express concern that the large amounts requested might not be fully justified, the Deputy Comptroller for Management Systems asked Treasury to withhold all DOD restorations pending further reviews and justifications. In September 1991, after receiving further justifications from DOD components, the DOD Principal Deputy Comptroller finally approved the restoration of \$1.7 billion of merged surplus authority to fund "M" account obligations incurred before December 6, 1990.

The IG continued to express concerns about DOD's final restoration amounts even though the amount had been reduced to \$1.7 billion. In reporting 2 on its review of DOD's restorations, the IG concluded that \$849 million of the \$1.7 billion was not adequately justified and should not have been restored. For example, the IG found that \$208 million of arbitrary adjustments had been made to align payment records maintained by the Defense Finance and Accounting Service (DFAS) with the accounting records at two major DOD activities. According to the IG, the one-time adjustment of \$208 million was made to balance the DOD activities' source obligation records with DFAS payment records. However, the IG noted that

Merged Accounts of the Department of Defense (Inspector General, Department of Defense Report No. 92-025, December 30, 1821).

the adjustment was made without performing any reconciliations to identify which accounts were correct.

Our follow-up review of an Air Force \$649 million restoration questioned by the IG also found that Air Force could not provide adequate support for the restoration. The reason for the \$649 million Air Force restoration and the results of our review of the restored amount are discussed in more detail in our response to question 4.

The DOD Deputy Comptroller (Management Systems) disagreed with the IG and refused to reduce the \$1.7 billion restoration. However, the Deputy Comptroller did agree to restrict the use of some of the restored amounts questioned by the IG until further reviews were completed. As of September 30, 1992, DOD had not completed its review of the balances. The restorations initially requested by the DOD components, amounts finally approved by the DOD Comptroller, and amounts supported by IG audit are shown in table II.2.

Table II.2: DOD Restorations by Activity

Dollars in millions	· · · · · · · · · · · · · · · · · · ·			
DOD activity	Amount initially requested	Amount approved by DOD Comptroller	Amount supported by DOD IG audit	Amount not supported by DOD IG audit
Air Force	\$ 1,685	\$ 901	\$ 144	\$ 757
Navy	619	362	313	49
Army	509	416	373	43
Other DOD	57	17	17	C
Total	\$2,870	\$1,696	\$847	\$849

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD disagreed that there was a lack of documentary evidence to support the merged surplus authority restorations approved by the DOD Deputy Comptroller. Further, DOD stated that the IG had not alleged a lack of documentary evidence to support specific amounts restored to the DOD components. Thus, according to DOD, we were incorrect in stating that the IG had concluded there was a lack of documentary evidence to support \$849 million of restorations.

DOD's assertion that we misrepresented the IG's findings and conclusions is incorrect. We met with responsible IG officials on January 11, 1993, to discuss DOD's comments, and the IG officials told us they concurred with

our draft report regarding their findings and conclusions on the lack of adequate documentary evidence to support the DOD restorations. They reiterated that the available documentary evidence was inadequate, and thus did not support the amounts restored. In fact, they said that our follow-up review of \$649 million of the \$849 million of the questioned restorations confirmed their findings that the restored amounts were not supported by adequate documentation. As a result of our additional discussions with the 1G and our own review of \$649 million, or 76 percent of the restorations in question, we maintain our position that DOD did not have adequate documentary evidence to support at least \$649 million of the \$1.7 billion of restorations made. This is discussed further in the "Agency Comments and Our Evaluation" section in our response to question 4.

Question 4

Air Force had 89 percent of the total DOD merged surplus authority restorations questioned by the DOD IG. Why did Air Force have such a large amount of questionable restorations?

Response

As shown in table II.2 in response to question 3, Air Force had \$757 million or 89 percent of pop's total \$849 million of merged surplus authority restorations questioned by the IG. Included in the \$757 million of questioned Air Force restorations was \$649 million that Air Force restored to its summary-level departmental accounting records to force them into balance with the "M" account obligation balances recorded in the Air Force field activity accounting records.

\$649 Million Restoration Made to Correct 30 Years of Errors

According to DOD and Air Force Comptroller officials, for nearly 30 years Air Force had been making adjusting entries to its departmental records for disbursements that had been made and reported to Treasury but had not been reported by Air Force field activities. Generally, these were disbursements of Air Force funds made by others on behalf of Air Force activities. These adjustments were intended to liquidate obligations on Air Force departmental and Treasury accounting records and bring obligations into agreement with the field activities accounting records. However, Air Force officials stated that because of miscalculations in the amount of unrecorded disbursements, amounts subsequently posted and reported by field level activities did not always agree with the adjusting entries recorded on departmental accounting records and reported to Treasury. As a result, obligated balances on Treasury and Air Force departmental records did not agree with Air Force field level balances. These differences, however, were not identified and reconciled.

According to DOD and Air Force Comptroller officials, the \$649 million obligation shortfall on departmental accounting records was not identified until Air Force began to review its "M" account balances as required by Public Law 101-510. With the passage of the November 1990 legislation, merged surplus authority previously available to cover the shortfall was to be canceled as of the close of business December 5, 1990. Air Force did not have time to research and resolve the discrepancies between departmental and field level records by this deadline. However, if it allowed the merged surplus authority to be canceled, it would have to pay any shortfall out of current funds. Rather than lose the funding authority, Air Force decided to restore the entire \$649 million to cover the recording

of obligations in departmental accounting records in order to bring them into balance with field level records.

DOD IG and DOD Comptroller Disagree on the Need for Restoration

Although the IG acknowledged that the \$649 million understatement in Air Force departmental accounts may represent valid obligations, the IG pointed out that there was no documentation containing specific details to support the obligations. The IG concluded that making global adjustments to accounting records without specific support for creating obligations was clearly not an accepted accounting practice. The IG recommended that the DOD Comptroller establish controls to withhold or otherwise restrict the use of all questioned restorations pending full justification and approval of previously unrecorded obligations.

The DOD Comptroller and Air Force officials disagreed with the 16 that the \$649 million was not adequately supported and therefore should not have been restored. According to DOD and Air Force officials, the departmental records had to be adjusted to agree with the detailed supporting records at the field activities. However, the officials acknowledged that Air Force lacked documentary evidence that identified exactly how the \$649 million difference occurred.

In response to the 16's concerns, the DOD Comptroller issued on February 18, 1992, separate memorandums to the Assistant Secretary of the Air Force (Financial Management and Comptroller) and the Director of DFAS requesting that they work together to investigate and correct Air Force departmental accounting records and exclude any unsupported adjustments to obligations identified in the 16's audit report. However, the DOD Comptroller did not specify when the review was to be completed and did not request that Air Force deobligate the unsupported restoration. DOD Comptroller officials told us that as of September 30, 1992, the investigation had not been completed.

Reasons for Accounting Differences Unknown

To obtain a better understanding of the \$649 million adjustment, we met with responsible officials from the offices of the IG, DOD Comptroller, Air Force, and DFAS to obtain their views on why the understatement occurred and to determine if the amounts were adequately supported to justify the restoration. We found that DOD officials' explanation that the error was caused by a miscalculation of the disbursements recorded on the departmental records was based on an opinion of a senior DFAS official. However, the same DFAS official advised us that there could have been

other causes for the difference in records, such as accounting and reporting errors by field level activities. The DFAS official acknowledged that this would mean that the field level records, as well as the departmental records, could be inaccurate. According to the DFAS official, since the difference in records is an accumulation of 30 years of errors, it is doubtful if Air Force will ever be able to reconcile the \$649 million difference between departmental and field level records.

Agency Comments and Our Evaluation

DOD disagreed with our finding that the \$649 million restoration was not supported by documentary evidence. DOD stated that documentation exists at the Denver Center, DFAS, to support the \$649 million difference between obligations recorded at the department-level and obligations recorded at the installation-level. As stated in our response above, we agree that differences existed between Air Force departmental and installation-level balances. What we disagree with is the restoration of \$649 million of additional budget authority to force the two sets of records into agreement without adequate documentary evidence to show that the \$649 million represented valid obligations. DOD's Accounting Manual (DOD 7220.9-M) states that an amount shall be recorded as an obligation only when supported by documentary evidence of the transaction. However, DOD acknowledged that it lacked documentary evidence identifying how the \$649 million difference occurred. DOD also stated that it had to adjust the departmental-level records to agree with the detailed supporting records at installation level, although DOD agreed that the installation-level records could be inaccurate. Further, DOD acknowledged that it is doubtful if the difference between the installation-level and departmental-level records could ever be reconciled since it represented an accumulation of 30 years of errors. Therefore, we maintain that the restoration of \$649 million to cover previously unrecorded obligations in departmental records simply to make them agree with installation-level records is not an acceptable accounting practice.



Question 5

Public Law 101-510 required DOD to audit all of its "M" account balances by December 31, 1991, to identify the amount of valid account balances on the DOD accounting records. Did DOD complete its audit as required?

Response

No. We found that as of December 31, 1991, pop had reviewed only \$5.2 billion of the \$18.8 billion of "M" account balances recorded in its records as of November 30, 1990. Section 1406 of Public Law 101-510 required the Secretary of Defense to provide for a one-time audit of each pop "M" account and to report to the Congress by December 31, 1991, on the amount of valid obligations in each account. Invalid amounts identified during the audit were to be deobligated and canceled.

The purpose of section 1406 was to prevent invalid obligation amounts in DOD "M" accounts that had accumulated over the years from being held and subsequently deobligated and used to fund adjustments to valid obligations. The Congress also wanted DOD to identify and maintain appropriate balances in "M" accounts that represented valid obligations remaining to be liquidated at the time of the audit.

In November 1990, the Secretary of Defense gave the 16 the responsibility of reviewing DOD's "M" account balances to identify and report on valid "M" account balances. The 16 coordinated work with the three military services' audit agencies to review a random sample of "M" account balances. According to the 16, over 175 auditors visited 211 military locations and issued over 40 individual audit reports. In summarizing the results of the individual audit reports, the 16 concluded in its final December 1991 report that DOD's "M" account balances were materially misstated, inadequately managed, and vulnerable to abuse. Of the \$5.2 billion of randomly sampled "M" account balances reviewed, the 16 found that \$2.9 billion were valid and \$2.3 billion were invalid and should be deobligated. The 16 considered obligations to be invalid when

- balances were not supported by adequate documentation;
- · disbursements were improperly posted;
- no disbursements had been made from the account during the last 2 fiscal years, and there was insufficient documentation to review the unpaid balance in more detail;
- the final payment had been made or funds were no longer required, and the remaining balance had not been deobligated; or

 the paying office had made disbursements, but the finance and accounting office had not posted the disbursements by November 4, 1990.

Based on the results of its sample, the 1G projected that, within a standard deviation of plus or minus \$2.2 billion, \$8 billion, or about 50 percent of the \$16.1 billion ³ in the universe of "M" account balances sampled were invalid.

Although the IG's statistical sample of DOD's "M" account balances allowed DOD to assess the magnitude of the problem, considerable additional work is needed to identify all specific invalid obligations in order to deobligate and cancel them as required by the law. On February 18, 1992, in response to the IG's audit report, the DOD Comptroller requested that each DOD component complete a review of all "M" account balances that had not yet been canceled and deobligate amounts not supported by documentary evidence. However, as of September 30, 1992, nearly 2 years after the legislation was enacted, DOD had still not finished its review of "M" account balances. According to the DOD Deputy Comptroller, the review is expected to be completed before the balances are canceled on September 30, 1993. Table II.3 shows the results of the IG's review of "M" account balances.

Table II.3: DOD Estimated Invalid "M" Account Balances as of November 30, 1990

Dollars in millions				
Activity	Amount In sample universe	Amount estimated to be invalid	Estimated percent of invalid balances	
Navy	\$ 6,501	\$ 3,656	56	
Air Force	6.056	3,335	5.5	
Army	3,326	901	27	
Other DOD	178	116	65	
Total	\$ 16,061	\$ 8,008	50	

The DOD IG's sample did not include (1) \$1.5 billion of smaller dollar appropriation accounts and (2) \$1.2 billion of adjustments made by Navy and Air Force that were either not provided to the auditors for review or the auditors could not reconcile the balances.

Question 6

DOD activities are using deobligated "M" account balances to fund upward adjustments to "M" account obligations as needed. If DOD has not fully complied with the section 1406 audit requirement, is it acceptable for it to use these deobligated balances to fund obligation adjustments?

Response

In our opinion, DOD's practice of deobligating and reobligating funds before all invalid balances are identified and canceled is not consistent with the purpose and objective of section 1406 of the 1990 Act. We identified over \$259 million of upward "M" account obligation adjustments made by various DOD activities since enactment of the legislation through July 31, 1992. The Congress subsequently enacted legislation on October 23, 1992, as part of the National Defense Authorization Act for Fiscal Year 1993 (Public Law 102-484), which restricts the amount of subsequent reobligations of DOD "M" account balances.

As previously discussed in our response to question 5, section 1406 of the 1990 Act required the Secretary of Defense to provide for a one-time audit of each DOD "M" account in order to identify (1) the balance in the account, (2) the amount of such balance that is considered to represent amounts required for valid obligations, and (3) the amount of such balance that is considered to represent amounts for obligations that are considered no longer valid. The law required that any amounts found to be invalid during the audit were to be deobligated and canceled. This legislative requirement was included because of congressional concerns that DOD would not voluntarily review its "M" account balances to identify and cancel invalid amounts.

The purpose of section 1406 of the 1990 Act is twofold. First, the Congress wanted to prevent invalid amounts in "M" accounts that DOD had accumulated over the years from being used as a reserve funding source under which invalid amounts would be deobligated and used to fund adjustments to other valid obligations as needed. Second, the Congress wanted DOD to identify and maintain the appropriate balances in "M" accounts that represented valid obligations remaining to be liquidated at the time of the audit.

We found, however, that DOD activities were routinely deobligating and reobligating "M" account balances as needed and brought this matter to the attention of congressional offices. For example, since the enactment of the legislation through July 31, 1992, agency officials told us that they had

reobligated over \$259 million of "M" account balances to fund other "M" account requirements. Public Law 102-484, section 1003, enacted on October 23, 1992, limited DOD's use of deobligated "M" account balances until DOD completes its required audit.

Among other things, the law requires that DOD (1) may not reobligate any sum in an "M" account until DOD has identified and canceled an equal sum and (2) provide the congressional defense committees a monthly report, for each month beginning after the date of the enactment of the legislation through September 30, 1993, on the amount of "M" account funds reobligated and canceled during the month. These requirements cease to apply if DOD completes its audit of the "M" account balances as required by Public Law 101-510.

Agency Comments and Our Evaluation

DOD disagreed that Public Law 101-510 restricted its practice of deobligating and reobligating merged account balances until it had completed its required audit. However, DOD did not provide us with any support for its position. Therefore, as stated in our report, in our opinion, DOD's practice of deobligating and reobligating funds before all invalid balances were identified and canceled was not consistent with the purpose and objective of section 1406 of Public Law 101-510.

Question 7

Public Law 101-510 authorizes agencies to use up to 1 percent of current appropriations to pay obligations that were recorded against canceled budget authority. What controls do agencies have to ensure that the 1 percent limit is not exceeded?

Response

Public Law 101-510 established a limit of 1 percent of current appropriations, available for the same purpose, that may be used to pay obligations related to canceled accounts, provided that the total payments do not exceed the unobligated expired balances of the appropriation to which the obligation was originally charged. The law further requires the head of the agency to approve increases in contract changes for a program, project, or activity which exceed \$4 million, and congressional notification for increases in a program, project, or activity exceeding \$25 million.

During fiscal year 1991, non reported using over \$26 million of current year appropriations to fund obligations that had been chargeable against canceled "M" account balances. We found that detailed records of canceled accounts are being maintained primarily at the activity level. In addition, the military service headquarters are maintaining summary balances on the amount of current obligational authority used to pay canceled accounts. For any transaction over \$100,000, the field activities are to obtain approval from headquarters before current funds can be obligated. Amounts below \$100,000 generally can be approved at major command level or lower, but must be reported monthly to service headquarters.

The six civil agencies we visited reported no payment of old obligations out of current appropriations during fiscal year 1991. However, we found that the agencies generally had controls to identify charges against current year funds and monitor the amounts to ensure that the 1 percent limitation on current appropriations as well as the legislative reporting requirements for the thresholds of \$4 million and \$25 million would be met. These controls included appropriation account codes to identify the payment of old obligations subject to the legislative reporting requirements and payments from current year funds subject to the 1 percent limitation. However, most of AID's funding is not subject to these requirements because the Congress has provided AID with appropriations that are not limited to a specific time period if obligated, and thus, do not expire. AID's exemption from these requirements and its funding are discussed in more detail in our responses to questions 12 and 13.

Question 8

In its guidance to implement Public Law 101-510, DOD required activities to use current year appropriations for within scope contract changes as opposed to applicable prior year expired funds. What is GAO's view on the use of current appropriations to fund obligation adjustments in expired accounts?

Response

We believe that the use of current year funds, without specific congressional approval, for within scope contract changes related to expired appropriations is improper. DOD required that, with limited exceptions, all additional costs incurred as a result of contract changes be funded out of current year funds regardless of which fiscal year's appropriation was obligated by the contract. This policy was a marked departure from the rules for obligating contract changes. Numerous Comptroller General decisions discussing these rules have held that within scope contract changes are chargeable to the appropriation initially obligated by the contract. Also, this policy, in effect, ignored the Antideficiency Act provisions which preclude agencies from exceeding amounts authorized in properly chargeable appropriation accounts or from incurring obligations in advance of appropriations.

In February 1992, we asked DOD to provide us with its legal justification for requiring the use of current year appropriations to fund within scope contract changes after the appropriation initially obligated by the contract had expired. ⁵ In April 1992, DOD notified us that it was rescinding its policy. However, no justification was provided for either the initial change in policy or DOD's decision to reverse the policy. We subsequently met with DOD Comptroller officials who told us that the reason for implementing the policy change was that it provided management with better financial control and accounting for contract changes. The officials told us that they decided to reverse the policy because of (1) confusion in the military services on how to implement the policy and (2) GAO's concern that the policy may not be appropriate. The DOD Comptroller officials advised us, however, that they do not plan to require that the policy change be made retroactive to reverse the millions of dollars already obligated against current year appropriations.

Senior Air Force and Navy Comptroller officials advised us that they had made about \$46 million and \$16 million, respectively, of within scope

⁴⁵⁹ Comp. Gen. 518 (1980); 44 Comp. Gen. 399 (1965); et. al.

^{*}Letter to Mr. Terrence O'Donnell, General Counsel, Department of Defense (B-245856.2, February 7, 1992).

contract changes that were funded out of current year appropriations during the period that the policy was in effect. According to the officials, had the policy not been changed, the \$62 million would have been obligated against the expired appropriations that initially obligated the contract. The Navy official told us that Navy had sufficient expired year funds to cover the \$16 million of charges it made. However, Navy had not investigated to confirm that sufficient expired funds were available to cover the charges. The Air Force official advised us that Air Force may not have had sufficient balances of unobligated expired funds to cover all of the obligations charged to current appropriations and acknowledged that a reportable Antideficiency Act violation may have occurred. Nevertheless, the official said that he had not been instructed to investigate any possible violations of the Antideficiency Act. Army Comptroller officials advised us that they did not incur any charges to current appropriations for within scope contract changes related to expired accounts.

Subsequently, the Congress passed Public Law 102-484, section 1004, on October 23, 1992, which authorizes DOD, subject to certain limitations, to charge current year funds for obligations and adjustments to obligations normally chargeable to expired accounts. Such use of current year funds is limited to those expired accounts that expired prior to fiscal year 1992 and are not closed. Thus, DOD is authorized to use current year funds for such things as within scope contract changes normally chargeable to expired years' funds. However, any overobligation in an expired account that is charged to current year funds remains a reportable violation of the Antideficiency Act, notwithstanding section 1004's authorization to pay prior year obligations using current year funds.

Agency Comments and Our Evaluation

pop generally agreed with our findings and recommendation. However, pop did not agree that it was improper to use current year appropriations to fund additional contract costs normally chargeable to expired years' accounts. As we stated in our report, numerous Comptroller General decisions discussing the rules for funding additional costs related to within scope contract changes have held that such costs are chargeable to the appropriation initially obligated by the contract. Although we asked pop's General Counsel to provide us with its legal justification for deviating from the Comptroller General decisions, none was provided. Therefore, in our opinion, pop's use of current year funds, without specific congressional approval, for within scope contract changes related to expired appropriations was improper.

Question 9

Although Public Law 101-510 cancels unspent funds after they have been in the expired stage for 5 years, agencies must still account for the canceled balances. How are agencies accounting for and reporting on funds canceled at the end of the 5-year period and are additional requirements needed?

Response

Canceled amounts are currently accounted for in temporary or memorandum accounts or not at all, and are not reported in current financial reports showing status of obligations. At the agencies we visited, we found that no formal policy exists to require continuous reporting of outstanding obligations after the underlying budget authority is canceled. As a result, federal agencies are not reporting billions of dollars of potentially valid obligations recorded against budget authority canceled by Public Law 101-510. As stated earlier, \$4 billion of obligated balances had been canceled as of September 30, 1991. However, the liability to pay these obligations upon receipt of a proper contractor invoice remains.

Canceled appropriation accounts must retain their fiscal year identity and the remaining balances should be adjusted downward as payments are made out of current appropriations to cover obligations of the canceled accounts. This procedure is necessary to ensure that payments do not exceed the originally appropriated amounts and result in Antideficiency Act violations. Consequently, agencies should retain records of the transactions related to the canceled appropriation accounts until such time as it is determined that there are no longer any outstanding claims against the accounts. In April 1992, we briefed OMB officials on the need for agencies to maintain adequate records on canceled balances.

OMB and the agencies we reviewed agreed that detailed reporting and monitoring of canceled amounts should be required to provide an accurate and complete overall picture of the government's outstanding obligations and to ensure that the accountability for these balances is not lost. OMB is drafting additional guidance for agencies to follow to ensure that canceled amounts are properly accounted for and disclosed in agency financial reports. OMB officials advised us that they plan to issue the policy by May 1993.

Agency Comments and Our Evaluation

In commenting on our draft report, DOD and OMB concurred with our findings and recommendation on this issue. OMB advised us that it had

proved For Release 2011/08/17 : CIA-RDP09K00541	
 Appendix II 18 Questions and Responses Concerning Agency Implementation of Public Law 101-510	
revised its planned date for issuing additi November or December 1992 until April o	onal reporting guidance from

Question 10

What effects could the new legislation have on agencies' procurement practices now that unspent funds on contracts will be canceled at the end of the 5-year expired period?

Response

Prior to Public Law 101-510, funds obligated on contracts were available until spent or deobligated. However, with the current 3-year transition period requiring "M" account cancellations and the future cancellation of 5-year old expired obligated and unobligated funds, agencies are facing major changes in the way they award and manage contracts. Among other things, agencies will be required to cancel budget authority supporting valid obligations of some active long running contracts based on the age of the funds. According to agency officials, many of the obligations associated with the canceled budget authority will eventually have to be funded with current appropriations up to the 1 percent limitation or by supplemental appropriations approved by the Congress.

Because the availability of expired budget authority is now limited to 5 years as opposed to the indefinite availability of "M" accounts, any management practice that does not allow an agency to identify and deobligate invalid obligations for other uses as quickly as possible must be avoided. Likewise, agencies must ensure that they do not follow management practices that might result in unnecessary use of expired appropriations. The cumulative effect of improper or poor management practices that result in the increased use of expired appropriations could lead to violations of the Antideficiency Act. To avoid these problems, managers will need to control and monitor any cost overruns as well as strengthen accountability and financial reporting, which were some of the reasons the Congress enacted Public Law 101-510. This will require agencies to implement tracking systems to account for and monitor older contracts to ensure that contract work can be completed before the unspent balances of appropriations are canceled.

Agency officials could not accurately estimate what the long-term effects would be on the procurement process since it will take several years under the new procedures before enough historical data can be compiled for such an analysis. However, the officials did express concerns about what they believe some of the long-term effects will be based upon their past experiences. Of primary concern was the ability to award shorter-term contracts that can be completed and paid before the appropriations are canceled. In the past, agencies generally did not have to worry about losing budget authority once the funds were obligated or

using current funds to pay for such things as cost overruns or contract changes.

One DOD activity's experience is typical of the perceptions and concerns of most of the agency officials we met with. Officials at this activity explained that they had a significant number of large complex contracts with performance periods well in excess of the 5-year expiration period during which appropriations are available for expenditure before they are canceled. Under the new law, most procurement appropriations will have to be obligated and expended within 8 years after the Congress appropriates the funds. This includes both the 3 years that the procurement appropriations are available for new obligations and the 5-year period after the funds' availability for new obligations expires.

The officials noted that contracts funded with procurement appropriations are generally driven by the cost, complexity, and risk associated with the supplies or services being procured. For example, most of the contracts for the launch and orbit of space vehicles contain incentive clauses that require payment to contractors based upon the space vehicle's success in achieving a specific orbit. In many cases, the incentive payments occur 10 years or more after the contract is initially awarded. In the past, these incentive payments were paid from the "M" account, but now will have to be made from current year appropriations at the expense of current programs or through supplemental appropriations.

The officials also pointed out that they are currently faced with a number of claims and litigation from contractors for additional costs under large complex contracts of relatively long duration. They stated that these claims and litigation will most probably not be resolved before the cancellation of unexpended contract funds. For example, in fiscal year 1990, a major contractor filed claims totaling \$235 million against a DOD activity for additional cost incurred but not paid. The contract is funded with fiscal year 1982 and 1983 procurement appropriations, which Public Law 101-510 canceled on September 30, 1991 and 1992, respectively. The officials estimated that it may take another 2 years to complete the examination of thousands of documents submitted to support or refute the contractor's claim. Thus, appropriations that were intended to fund current programs may now be used to pay for work budgeted and contracted for many years earlier.

Question 11

Will the audit agencies be able to complete contract audits within the required period of time before the funds are canceled?

Response

Final payment for many civil agency and DOD contracts cannot be made until the Defense Contract Audit Agency (DCAA) completes its audit and, even before Public Law 101-510, DCAA was unable to complete all required contract closeout audits on a timely basis. However, officials at the civilian agencies we reviewed told us that they do not have the volume and complexity of contracts subject to DCAA audit, as does DOD. Generally, the officials stated that they are shifting resources to complete the audits of older contracts before funds are canceled.

DOD's situation, however, is quite different. According to a recent 1G audit, 6 DCAA had a 2-year audit backlog of contractors' incurred costs totaling \$144.5 billion at the end of fiscal year 1991, and is facing additional major budget reductions of 1,140 authorized staff years that will increase its backlog to an estimated \$192 billion by the end of fiscal year 1995. The 1G identified at least 5,841 overage contracts with unliquidated obligations 7 totaling \$24.8 billion that were awaiting DCAA audit on July 1991. Contracts are classified as overage when they reach 36 months past physical completion. Although the 1G concluded that there was no precise means to identify the dollar impact that the backlog of work might have on the cancellation of unspent funds, the 1G estimated that a "rough order" of over \$400 million a year in unpaid obligations could be canceled before DCAA can complete its audits. The IG believed that DCAA would need to reduce its backlog to 1 year in order to ensure that the contract audits can be completed before the funds are canceled. According to the 1G, funds are owed by DOD on final settlement of contracts for such things as provisional overhead rates and other reserves. The 1G noted that any payments related to the canceled balances of the closed accounts would have to be paid out of current year appropriations.



^{*}Report on Oversight Review of Defense Contract Audit Agency Incurred Cost Audit Backlog Effect on DOD Obligations (*M* Accounts) (Inspector General, Department of Defense Report No. APO 92-005, May 1, 1992).

Unliquidated obligations are the balances of an appropriation account that remain obligated but unexpended.

Question 12

Which agencies have been granted exemptions or waivers from Public Law 101-510 and why were they necessary?

Response



We have identified the following specific legislative exemptions from Public Law 101-510's requirement that expired appropriations be canceled:

- Public Law 102-170 exempts the Department of Education's College Housing and Academic Facilities Loans.
- Public Law 102-27 exempts HUD Community Development Grants and Urban Development Action Grant Programs, and the Library of Congress Books for the Blind and Physically Handicapped Program.
- Public Law 102-240, section 3036, exempts the Federal Transit Administration's (formerly Urban Mass Transit Administration) Urban Discretionary Grants and Interstate Transfer Grants-Transit.

These exemptions were generally provided due to the long-term nature of existing agreements for construction and development projects with third parties.

In addition, the President, under the authority of the Foreign Assistance Act of 1961, as amended, waived the 1991 cancellation of "M" account balances required by Public Law 101-510 for AID's foreign assistance programs until September 30, 1992. Because of the long-term nature of these programs, cancellation of funds was determined to have serious foreign policy consequences. Through the congressional appropriation process, AID had requested that the cancellation of fiscal years 1985 and 1986 "M" accounts be extended until September 30, 1994. However, AID's request was not enacted. As of September 30, 1992, AID is in the process of closing its fiscal year 1985 and prior "M" account balances and planned to cancel all its balances on September 30, 1993, as required by Public Law 101-510.

Question 13

What is the size of agency no-year fund balances? Are they constitutional, why are they necessary, and, in particular, how are they being used by AD?

Response

As of September 30, 1991, federal agencies had accumulated a reported \$463 billion of unspent no-year appropriations that are available indefinitely until closed under the provisions of Public Law 101-510. The appropriation by the Congress of no-year funds has been viewed by federal courts as constitutional. In this regard, the federal courts have recognized that the Congress, in making appropriations, may designate the terms and conditions regarding the availability of appropriations including the length of time available to support obligations.

No-year funds remain available indefinitely until spent or canceled. Public Law 101-510 provides for the closing of no-year accounts if (1) the head of the agency concerned or the President decides that the purpose for which the appropriation was made has been carried out and (2) no disbursement has been made against the appropriation for 2 consecutive fiscal years.

As shown in table II.4, agency no-year fund balances, as reported to Treasury, have increased 8 percent, from \$429 billion as of September 30, 1990, to \$463 billion as of September 30, 1991. The addition of \$15 billion in 1991 to the Persian Gulf Defense Fund within the "Other" Defense appropriation accounted for 44 percent of the increase. In commenting on a draft of this report, OMB and DOD noted that in September 1992, Public Law 102-368 rescinded \$14.7 billion of the \$15 billion of the no-year appropriations for the Persian Gulf Defense Fund.

Table II.4: Executive Agencies'
No-Year Appropriation Balances as of
September 30, 1990 and 1991

Dollars in millions		
Agency	1990	1991
Funds Appropriated to the President:		
Military Sales Program	\$ 19,765	\$ 21,996
International Monetary Fund	13,909	13,978
International Development:		
Financial Institutions	11,109	11,471
Agency for International Development	312	720
Other	360	678
Total Funds Appropriated to the President	45,455	48,843
Agriculture	3,890	4,801
Commerce	1,609	1,617
Defense:		********
Air Force	1,240	2,407
Army	2,913	3,485
Navy	6,022	5,972
Other	9,530	22,433
Total Defense	19,705	34,297
Education	1,243	1,055
Energy	9,656	13,177
Health and Human Services	1,400	3,824
Housing and Urban Development	208,529	211,480
Interior	3,555	4,586
Justice	3,542	4,04
Labor	236	550
State	1,254	1,08
Transportation	49,657	48,08
Treasury	51,013	54,22
Veterans Affairs	3,809	5,19
Environmental Protection Agency	7,902	7,68
General Services Administration	3,233	4,77
National Aeronautics and Space Administration	799	67
Office of Personnel Management	1,215	1,52
Small Business Administration	1,606	1,23
Independent agences	9,254	10,04
Total All Agencies	\$428,562	\$462,80

Source: Data compiled from Treasury's Annual Reports and not verified.

Program and activities involving long-term contractual commitments, such as construction, offer compelling reasons for no-year funds. These reasons include program flexibility, financial management, and accounting efficiency. Large, unspent balances, however, reduce congressional control. Therefore, close scrutiny of no-year funding requests is prudent. Without careful monitoring, unspent no-year appropriations may accumulate, resulting in large balances subject to little oversight. A similar situation regarding "M" accounts and merged surplus authority prompted the passage of Public Law 101-510.

Since fiscal year 1987, about 85 percent of Am's funding has been in the form of appropriations that become no-year funds if they are obligated within the period of availability. These funds are not subject to the restrictions imposed by Public Law 101-510 for finite appropriations. The use of large amounts of no-year funds by Am is discussed in our report, Foreign Assistance: Am's Implementation of Expired Appropriation Account Legislation (GAONSIAD-92-189BR, May 20, 1992).

Objectives, Scope, and Methodology

Our objectives were to (1) assess the guidelines for implementing Public Law 101-510, (2) evaluate agency compliance with the applicable guidelines, and (3) address other specific issues raised during briefings to the congressional requesters' offices.

To assess guidance provided to agencies, we reviewed pertinent Office of Management and Budget and Treasury guidance and compared it to Public Law 101-510. To obtain an understanding of how agencies were implementing the new requirements, we selected the seven agencies that had the largest "M" account balances in Treasury's annual reports as of September 30, 1990. The seven agencies were the Departments of Defense, Education, Health and Human Services, Housing and Urban Development, Labor, and Transportation and the Agency for International Development. To determine if the seven agencies adequately implemented this guidance, we met with responsible accounting officials to discuss their policies and procedures for

- identifying and canceling invalid "M" account obligations recorded in their accounting records,
- · determining the amount of merged surplus authority to restore and cancel,
- monitoring and reporting on the use of current year appropriations to pay canceled "M" account obligations, and
- accounting for and controlling upward adjustments to contract changes funded with "M" account or expired appropriations.

To determine how the seven agencies implemented their policies and procedures, we interviewed responsible agency accounting and 16 officials and, as necessary, reviewed pertinent accounting records, reports, and available internal studies that included information on the procedures used by the agencies to comply with the above legislative requirements.

At DOD, we coordinated our work with the DOD Office of Inspector General which was conducting a Defense-wide audit of DOD's "M" accounts to determine, among other things, the (1) amount of valid balances in the accounts and (2) status of merged surplus authority restorations made between October 1, 1990, and December 5, 1990. To avoid duplication of effort, we limited the scope of our work in these two areas and used the results of the IG's audit in our report. However, we did additional follow-up work on a \$649 million Air Force merged surplus authority restoration questioned by the IG to determine if the restoration was justified and adequately supported. To complete this work, we met with responsible officials from the IG and DOD and reviewed pertinent supporting accounting

Appendix III
Objectives, Scope, and Methodology

records and reports. Except for the \$649 million at the Air Force, the percentages of valid and invalid "M" account balances and dollar values of merged surplus authority restorations for the seven agencies discussed in the report were obtained from 16 audit reports or compiled from agency and Treasury records and were not audited by us.

To determine how the legislation could affect federal agencies' procurement practices, we questioned responsible agency and IG officials to obtain their views on the effects of the legislation on their operations. At DOD we also reviewed internal agency memorandums, briefing reports, and proposed legislative changes that discussed what would have to be done to ensure that contracts could be awarded and completed before unspent appropriations were canceled at the end of the 5-year expired period.

To identify federal agencies and activities that received exemptions or waivers from the act, we asked responsible officials at each of the seven agencies to provide us with a list of and legislative support for exempt agencies and programs, and the reasons for the exemption or waiver. We validated this information and conducted our own legislative research for exempt or waivered activities.

To identify no-year appropriations balances, we analyzed Treasury's fiscal year 1990 and 1991 year-end closing statements (TFS 2108), as reported by agencies and compiled a schedule but did not verify these data. We also researched the legal basis for no-year funds.

We performed our work at Treasury and the headquarters of the six civil agencies we selected for detailed review, all located in Washington, D.C. We performed work at the following DOD locations: the headquarters for the Offices of the Secretaries of Defense, the Army, and the Air Force, Washington, D.C.; the Navy Comptroller, Defense Finance and Accounting Service, and DOD Inspector General, Arlington, Virginia; the Defense Contract Management Command and Army Materiel Command, Alexandria, Virginia; the Air Force Systems Command, Andrews Air Force Base, Washington, D.C.; the Air Force Logistics Command and Air Force Aeronautical Systems Division, Wright Patterson Air Force Base, Dayton, Ohio; the Defense Finance and Accounting Service Center, Denver, Colorado; and the Defense Finance and Accounting Service Center, Indianapolis, Indiana. Our work was performed between August 1991 and October 1992 in accordance with generally accepted government auditing standards.